Supreme Court, U.S.
FILED
MAR 10 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-1155 (3)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

PAPAGO TRIBAL UTILITY AUTHORITY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION OF ARIZONA PUBLIC SERVICE COMPANY

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March 1986

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Whether the court of appeals correctly refused to disturb reasoned decisions of the Federal Energy Regulatory Commission that, in conformity with the precedents of this Court, balance the interests of ratepayers and shareholders in setting rates under the Federal Power Act?

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Arizona Public Service Company ("APS"), an intervenor in support of respondent Federal Energy Regulatory Commission below, hereby submits this brief in opposition to the Petition for Writ of Certiorari to review the judgment entered in this case on October 10, 1985.

OPINIONS BELOW

An adequate citation to the opinion delivered by the court of appeals below and by the Federal Energy

Regulatory Commission ("FERC" or "Commission") is made in the Petition. The opinion of the court below is reported at 773 F.2d 1056 (9th Cir. 1985).

JURISDICTION

The jurisdictional requisites are set forth adequately in the Petition.

STATUTE INVOLVED

The statutory provisions involved are set forth adequately in the Petition.

COUNTERSTATEMENT OF THE CASE

Arizona Public Service Company renders utility service in the State of Arizona. As an electric utility, APS engages in the generation, transmission, and distribution of electric energy. The company's wholesale sales of electric energy are subject to regulation by the FERC pursuant to the Federal Power Act, 16 U.S.C. §§ 791a-824r.

This proceeding arises from a general rate case filing made by APS on December 18, 1980. APS proposed changes in rates for 17 wholesale customers. The proposed rate changes were designed to produce a revenue increase of $14,736,554. In accordance with the Commission's regulations, APS submitted financial and other data concerning historical (Period I) and future projected (Period II) time periods. 18 C.F.R. § 35.13(d)(1980). Following its usual procedures, the Commission accepted the proposed rates for filing, and set the matter for hearing before an administrative law judge.

An evidentiary hearing was convened on November 17, 1981. The hearing concluded a month later after producing nearly 2400 pages of transcript.

On March 8, 1982, after the hearing proceeding had been closed for more than three months, the Commission's Trial Staff filed a petition seeking to reopen the proceeding. The Staff sought to reopen the proceeding to propose certain changes in APS' rates because of the sale by APS to General Electric Company ("GE") of certain investment tax credits and tax depreciation entitlements associated with the fourth unit at the Company's Cholla Electric Generating Station ("Cholla 4"). The Presiding Administrative Law Judge granted the motion, reopened the record, and ordered further hearings for the purpose of receiving evidence related to this issue. This became Phase II of the proceeding.

The hearing in Phase II was conducted on May 18 through May 21, 1982. The record in this phase consisted of the testimony in Phase I with respect to the tax benefit transfer (the matter had been discussed briefly during the original hearing) plus an additional 38 exhibits and 673 pages of transcript.

Following the hearings, the issues in Phase I and Phase II of the proceeding were each the subject of lengthy initial decisions by the Presiding Administrative Law Judge and two orders of the Commission.

THE TAX BENEFIT TRANSFER

On November 11, 1981, APS transferred to GE certain investment tax credits ("ITC") and accelerated cost recovery system ("ACRS") depreciation deductions for the sum of $50,625,000. This transaction

was consummated pursuant to the expanded "safe-harbor" leasing provisions of Section 168(f)(8) of the Internal Revenue Code ("IRC" or "Code"), as implemented by Section 201(a) of the Economic Recovery Tax Act of 1981[1], Pub. L. No. 97-34, 95 Stat. 172 ("ERTA").[1]

Section 168(f)(8) of the Code, as effective in November 1981, provided that an agreement covering "qualified leased property" would be treated for federal tax purposes as a lease if certain specified requirements were met and "all of the parties to the agreement characterize" it as a lease. The tax benefit sale at issue here met all of these requirements.

The safe harbor lease was arranged as a "sale and leaseback" in which GE purchased Cholla 4 from APS and immediately leased it back to the Company. GE made a down payment of $50,625,000 for the property with the balance secured by a note. The transaction was structured so that APS' total rental payments exactly equal—and thus offset—the debt payments (principal and interest) on the note. GE is the owner of the property for tax purposes and is entitled to the tax benefits associated with that property. The down payment is the only cash that will pass between the parties and therefore represents the sale price of the transferred tax benefits. Thus, the effect of the safe harbor leasing provision of the Code was to permit companies such as APS to sell their future tax benefits for present day cash, or to permit companies with more tax benefits than they could use to sell them for cash to companies that could use them.

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[1] The leasing provisions of ERTA were substantially amended by Section 208(b)(3) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 342.

The leasing transaction was approved in a ratemaking and accounting order issued by the Arizona Corporation Commission ("ACC"), which regulates the Company's retail sales and operations, on October 27, 1981.[2] In its order, the ACC required APS to record the $50 million payment received from GE in a separate account and to amortize the balance in that account as a reduction to the Company's rates on a straight line basis, *i.e.*, in equal installments, over the remaining book life of Cholla 4. The ACC also required APS to reduce its cost of service every year to reflect the income tax effect of the difference between the rental deductions and interest income. These steps assured that APS' ratepayers, in addition to the Company, would receive some of the benefits of the tax entitlement sale.

THE DECISIONS BELOW

As noted, the Administrative Law Judge ("ALJ") assigned by the Commission to hear the case rendered two Initial Decisions. The first, in Phase I of the proceeding, concerned ratemaking issues no longer the subject of this appeal. The second, in Phase II, addressed issues relating to the tax benefit transfer.

Before the Commission and the court of appeals, APS urged that the proceeds received from the tax benefit transfer be treated for federal ratemaking purposes in the same way as they were treated for ratemaking purposes before the Arizona Corporation Commission. That is, the proceeds would be used to

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[2] Approximately 90% of the Company's revenues come from its retail operations.

reduce APS' electric rates by amortizing them over the remaining book life of the Cholla 4 facility (a little less than 30 years). This treatment, APS submitted, was consistent with federal tax laws, and would ensure that future ratepayers, who will be required to pay a portion of the lease payments, will also receive part of the benefit of the sale of the Cholla 4 tax entitlements.

PTUA, on the other hand, argued that all of the tax benefit proceeds should be flowed through to ratepayers immediately. PTUA further argued that the value of the proceeds received by APS was far less than their value to the ratepayers, and that APS had somehow been "imprudent" in entering into the transaction with GE. PTUA therefore argued, in the alternative, that APS' rates should be fixed as if the sale had never taken place, and it proposed a complicated scheme that it claimed would achieve that result.

The ALJ and the Commission rejected both proposals. The ALJ ruled that APS' proposal did not give sufficient benefits to the ratepayers, while PTUA's proposal was unduly punitive of APS. The ALJ expressly rejected the notion that APS had somehow been "imprudent" or breached its duty to the ratepayers; he also refused to adopt the fictitious premise advanced by PTUA that the transaction had never taken place.

The ratemaking treatment favored by the ALJ and ultimately adopted by the Commission requires APS to flow through the proceeds received from GE over the book life of Cholla 4 (as suggested by APS). In addition, however, APS is also required to reduce its rate base each year (and hence its rates) by the

amount of the unamortized balance of the proceeds. Thus, ratepayers receive both the benefit of ratable flow through of the $50 million proceeds, and a rate base reduction of the unamortized amount remaining to be flowed through. In addition, APS is required to flow through the tax savings resulting from the equal "rent" and "purchase price" payments under the agreement with GE.

On appeal, the Ninth Circuit affirmed the balance struck by the Commission. The court held that Commission had reasonably exercised its discretion in fashioning the ratemaking treatment for this unique transaction, and that the Commission's choices were supported by substantial evidence. The court rejected PTUA's allegations that APS had been imprudent or breached its duty to the ratepayers, pointing out that one of Congress' central purposes in enacting the safe-harbor leasing provisions of the tax code was to make it perfectly lawful for companies such as APS to enter into tax benefit sales.

ARGUMENT

I. This Proceeding Does Not Involve An Issue of Vital National Concern

Longstanding precedent holds that a writ of certiorari should be granted only for cases of "peculiar gravity and general importance." *American Construction Co. v. Jacksonville, T. & K.W. Ry. Co.*, 148 U.S. 372, 383 (1893). This case concerns the one-time sale of tax benefits under a statute that was in effect for approximately one year. Thus, it is hardly a matter "affecting the interests of this nation in its internal or external relations," *Forsyth v. City of*

Hammond, 166 U.S. 506, 515 (1897), and certiorari should be denied.

Because the safe harbor leasing provisions of the tax code have been repealed, no other transaction of this kind can be consummated. Furthermore, to the knowledge of counsel, none of the few other utilities that entered into transactions similar to that of APS are any longer in litigation with regard to the effect of the proceeds on wholesale rates. Thus, the ruling in this case will only affect this single transaction. APS in no way intends to disparage the importance of this proceeding, either to PTUA or any other utility customer. At the same time, however, it strains credulity to suggest that this is a case of paramount national interest.

II. No Conflict Exists Between the Decision of the Court of Appeals and the Precedents of this Court

PTUA suggests that the decision of the Ninth Circuit is somehow in conflict with the venerable decision of this Court in *SEC v. Chenery Corp.*, 318 U.S. 80 (1943). PTUA asserts that the Ninth Circuit affirmed the Commission's decision "on grounds not only not relied on but specifically rejected by the agency." Petition at 10. PTUA, however, has misconstrued the decision of both the court of appeals and the Commission.

At issue is PTUA's strident assertion that APS was somehow "imprudent" in selling the tax entitlements to GE for a mere $50 million. Before the Commission, PTUA argued that the tax entitlements were worth literally hundreds of millions of dollars,[3] and sup-

[3] PTUA offered a variety of figures throughout the proceeding for the amount of the "loss," ranging up to about $500 million.

ported this assertion with the testimony of a witness. PTUA reasoned that since APS had negotiated such an inadequate price for the tax benefits, it was guilty of imprudence and should be forced to make up the difference.

APS responded to PTUA's allegations by pointing out that the tax benefit sale was freely negotiated at arm's length between two large, sophisticated companies. APS demonstrated that the price obtained was well within the range of market values prevalent for tax benefits at the time. APS pointed out that no testimony was presented by PTUA concerning how any better price could have been obtained. APS supplied testimony that the sale of the future tax entitlements for present cash served a vital business purpose: at the time of the sale, APS was experiencing cash flow difficulties; and the infusion of cash served to improve the Company's financial profile at a time in its history when cash was sorely needed. Finally, APS argued that the intent of Congress in enacting the expanded safe harbor provisions of the Code was to encourage transactions of the type complained of so strenuously by PTUA.

The ALJ, the Commission, and the court of appeals all rejected PTUA's allegations that APS had been imprudent. The ALJ stated:

> The evidence conclusively shows that the negotiations between APS and General Electric took place at arm's length. The weight of the evidence also shows that APS secured about the best price it could have expected for its tax benefits, given the then-current market for tax depreciation and investment tax

> credits, as well as the rather brief period of time the law provided for a safe harbor sale of ACRS [depreciation] deductions and investment tax credits attributable to investment in Cholla No. 4.

Pet. App. 55a.

Even agreeing that the tax entitlements should be valued at something more than the $50 million received, the ALJ pointed out, APS violated no duty to the ratepayers by entering into the transaction with GE. He observed that it is the job of the Commission to protect the ratepayers. He concluded that APS was not acting imprudently when it entered into a lawful transaction that served a valuable business purpose for the Company. He noted, however, that it was the Commission's responsibility to fashion an appropriate ratemaking treatment for the proceeds, Pet. App. 55a-57a, and he then proceeded to do so. On review, the Commission affirmed this part of his analysis[4] without comment.

The Ninth Circuit also rejected PTUA's claims. The court of appeals stated that PTUA had failed to demonstrate that the ALJ (and the Commission) erred in holding that APS had not been imprudent or unlawful in entering into the transaction. The court of appeals found particularly persuasive the fact that one of Congress' central purposes in enacting the safe harbor leasing provision was to make it legal for com-

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[4] Throughout the proceeding, PTUA complained that APS had been imprudent not just in the tax benefit sale, but also by constructing overly expensive power plants, failing to adopt sufficient conservation measures, and so forth. PTUA has apparently abandoned these issues.

panies such as APS to transfer future tax benefits into current income. Pet. App. 17a. The court of appeals therefore declined "to disturb the ALJ's exercise of his sound discretion in concluding that APS acted prudently in selling the tax benefits to General Electric." *Id.*

APS submits that there is no conflict between the decision of the court of appeals and that of the Commission; thus, the *Chenery* doctrine is not implicated in this case. The court specifically affirmed the ALJ's exercise of his sound discretion. The court did not substitute its judgment for that of the Commission, nor did it affirm on a different ground than relied upon by the FERC. All the court did was to decline PTUA's invitataion, as had the Commission, to substitute its judgment for the business judgment of APS in entering into an important transaction providing it with vitally needed cash.

Section 205 and Section 206 of the Federal Power Act require that rates set under the Act be "just and reasonable," which in turn requires that rates reflect a balancing of the interests of APS' ratepayers and shareholders. After taking all aspects of the transaction into consideration, the Commission discharged its responsibility of weighing the interests of APS' ratepayers and investors, and of fashioning a rate treatment that produces a reasonable result. The Commission thus conformed to the long-standing principles of this Court, as enunciated in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).[5] In af-

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[5] The *Hope* case interpreted Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c and 717d, provisions that parallel Sections 205 and 206 of the Federal Power Act, 16 U.S.C. §§ 824d and 824e.

firming the Commission, the court of appeals likewise adhered to the deferential standard of judicial review set forth in *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968), and refused to disturb the end result of the Commission's balancing of the divergent interests, since that result was premised on a reasoned consideration of the agency's statutory duties.

III. The Court Below Did Not Adopt a Per Se Rule of Prudence

PTUA complains that the Ninth Circuit held that a utility is *per se* prudent if its actions, although lawful, impose unnecessary additional costs on ratepayers. With all due respect, that is not what the court held.

The Ninth Circuit's decision upheld the ALJ's finding, adopted by the Commission, that on the record presented, APS was not imprudent. The court laid down no *per se* rule, nor did the Commission. The words "*per se*" are not found in either the court's or the Commission's decisions. Nor does the rationale of the Commission, affirmed by the Ninth Circuit, support a *per se* rule. The Commission and the court merely held that on the facts presented in this case, APS could not be held to be imprudent. PTUA's assertion that this constitutes a *per se* rule simply has no basis in the record.

It should be noted that the Commission did fashion what it considered to be an appropriate ratemaking treatment for the tax benefit proceeds. This treatment was not what APS had proposed, nor was it what PTUA had offered. But the Commission did undertake an exhaustive investigation of how APS' rates should reflect the effects of the safe harbor lease;

and the Ninth Circuit affirmed the results of that study. Neither the Commission nor the court adopted a *per se* rule, or blindly ignored the effects of the transaction on APS' ratepayers. The Commission balanced the factors it considered most important in determining the structure of APS' rates. The fact that APS engaged in a transaction that may have the effect of increasing rates in future years does not, by itself, result in unjust and reasonable rates, so long as the Commission has carefully balanced the interests of the ratepayers and the shareholders in developing a rate treatment in response to the transaction. In approving the Commission's action, the Ninth Circuit applied the appropriate standard of review in conformity with clear precedent of this Court. *FPC v. Memphis Light, Gas & Water Division*, 411 U.S. 458, 474 (1973).

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.[6]

Respectfully submitted,

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[6] Because, in APS' view, PTUA has failed to demonstrate any error in the Court's or the Commission's analysis, thereby warranting denial of certiorari, its suggestion for summary reversal must also be rejected.